AN APPRAISAL OF THE INTERRELATIONSHIP OF PUBLIC ACCOUNTING AND THE CONCEPTS OF INCOME TAX ADMINISTRATION

BY

JAMES OWEN EATON

B.S., University of Illinois, 1937
M.S., University of Illinois, 1947

AN ABSTRACT OF A THESIS

SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF DOCTOR OF PHILOSOPHY IN ACCOUNTANCY
IN THE GRADUATE COLLEGE OF THE
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Introduction

The *Bercu* case in New York "convicting" a public accountant for the unauthorized practice of tax law; the Administrative Procedure Act of 1946 forcing the governing process closer to the litigious pattern; the Supreme Court decision in and the legislative repeal of the rule laid down in the *Dobson* case which had held that the expertness of the Tax Court justified placing final authority therein over tax accounting questions; the proposed Administrative Practitioners' Bill designed for restricting non-lawyer participation in negotiations before federal agencies; and continuing effects to make the Tax Court a court of record, all represent a growing resistance to the professional participation of public accountants in the overall taxing process. Moreover, all also represent a basic resistance to a much needed improvement in tax administration.

By common consent both within and without official government circles our tax administration has become progressively and increasingly inept, costly, protracted and, what is of crucial importance, distrusted by taxpayers. This worsening of tax administration and the resistance met by accountants have been accompanied by the ascendancy of the legal profession in tax administration.

Our failure to secure the efficient taxing process we desire started with our refusal to meet the prerequisites of such a process as set forth in connection with the Board of Tax Appeals pre-1924 discussions. In essence our inability to improve tax administration is only an expression of a philosophy of government which is founded on an adversary relationship between government and citizen.

It is of interest to analyze the correlation among such factors as our inefficient tax administration, the ascendancy of the legal profession in government along with the re-emphasis of the government-taxpayer adversary relationship, the withholding of informal professional discretionary authority from professional agencies of government, and the growing resistance met by professional accountants in tax practice.

The approach by which professionalism attempted to follow its respective discipline into the government became known as the "administrative" approach to distinguish it from the older, traditional "common law" approach. It is emphasized that conceptually both approaches or concepts of tax administration are identical as to purpose. Both would apply experience to current problems to ascertain justice as a correct conclusion. However, their methodologies differ profoundly.

Accountants know that to separate the techniques and methodology of accounting from those individuals nurtured in its social philosophy, which begat the profession of public accounting, is to vitiate juridical purpose of public accounting in society. Yet instead of permitting accountants to market their public service indirectly through a professional expert government agency, as they had customarily theretofore done directly to the public, the income tax law, through the common law mechanism, has proceeded to assimilate and inevitably to dissipate the underlying premises of accounting techniques. The result has been to nullify the fiduciary potential accountants had by a purely administrative solution to the income tax problem and to ignore the fact that the public and management have habitually relied on the professional integrity of accountants outside of tax administration.

The need for a fiduciary is inherent in the multitude of conflicting interests in our complex society and in the obvious possibilities for bias on the part of those shouldering direct responsibility. The public accountant did not create the need for a fiduciary in socio-commercial relationships. He merely performs the public service in particular areas. As a fiduciary the accountant is a medium which must impart reliability to

financial statement representations enroute to interested parties. He is of value to either party at interest only so long as both have confidence in him. He enables the client to assure the public at large that the client has discharged his social responsibility. To insist on injecting this assurance into the atmosphere of formal litigation, as is done in our tax administration, is to misinterpret the need for a fiduciary into a need for formal litigation.

Interpretative Problems and Methods

The basic problem of tax administration is that of interpreting business data with the view of determining the tax base from which the tax is to be exacted. Economic justice and the realities of the individual business entity as a continuing enterprise require the equilibrating of and the recognition of the relevancy between revenue and costs within arbitrary uniform time periods.

The legal time periods covered by legal documents are not suitable as the periodic basis on which to disclose the economic values represented by the documents for the cogent reason that not all documental periods are coterminous. Even if this multitude of documental periods were coterminous, it would not necessarily mean that the documental evidence coincided with the economic evidence of value exchanges. The economic values, then, must be differentiated from their legal documents and fitted into uniform arbitrary time periods. It is this matching of value exchanges to a common time period, usually one year, that is the essence of accrual accounting. And it is this essence that requires professional training and expertism and informed judgment quite incompatible with and non-procurable by the judiciary interpretative mechanism. The bland assumption that accounting or economic accrual is synonymous with legal accrual and documental dates and producible within the judiciary process is the one source of tax accounting anomalies. This assumption is, of course, necessary if one is to justify the arrogation of the accounting interpretations in the first instance.

The common law legal process purports to apply experience as precedents to current cases by a concept of analogy known as *stare decisis.* The actual procedure requires that these precedents be presented to the judge by opposing contestants bent only on prejudicing the mind of the judge and in no way concerned with the proper interpretation of the business data in question. What the data *ought to* mean in view of its purposive origin is not a primary concern. Under this judiciary process there is no analysis, synthesis, or distillation of experience prior to the trial. There is no scientific formulation of the knowledge which is imbedded within those experiences or happenings. Justice purports to be the result of a certain and mechanical process. Such an aura of certainty according to eminent authorities is pure dupery.

Turning to the "judicial" process of non-legal disciplines, such as accounting or medicine, it becomes apparent that here the tripartite process has been replaced by a decidedly non-litigious investigation of those past experiences. The multi-party, *stare decisis,* formal record requirements of the common law judiciary process designed to insure the integrity of the interpretation have their counterpart in the expert and impartial judgment implied in the professionalism of non-legal disciplines. It is this fact that would permit an administrative solution to our tax problem which would reduce greatly the delay and distrust of our present procedure. Yet it is this same necessity for relying on professional integrity that has prevented our common law legal philosophers who control our government from accepting the better approach to tax administration. All judgment and discretion, be it professional or otherwise, is potentially arbitrary and dictatorial, or so it is implied in legalistic arguments.

The crucial distinction between the non-legal and legal interpretative processes lies in the concept of preformulated objectives of the former. For example, accounting has greatly refined the analysis of business experiences beyond the relatively shallow approach of doctrinaire *stare decisis.* Based on the function of business enterprise in our economy

and on previous experiences in performing its function, there has evolved gradually a relevant interpretation of business. That relevancy is expressed in accounting principles, methodology, and concepts. Those trained to understand business and the relevant accounting objectives can interpret business results, without the need for the tripartite judiciary procedure, by relating current data with those objectives. As business experiences or transactions recur, their meaning or interpretation is a process of associating them with those objectives.

Our solution to tax administration which induces a taxpayer to equate the cost and a natural distaste for impending litigation with the assessed tax deficiency as a method of "settlement," scarcely contributes to a non-litigious, cooperative spirit between the government and the taxpayer. Moreover, when the tax practitioner agrees to base his fee on the contingency that he can beat the deficiency in court, there is little reason why the taxpayer should refuse to gamble. The game has already been arranged; the dice have already been rolled. The government by assessing the deficiency has already placed the taxpayer's bet for him. Not only is the government a likely biased party in this game, but it is too often in a position to crush the resistance of the average taxpayer through "stacking the procedural deck" with costly, complex, and protracted "red-tape," and that by itself breeds contempt. There is common sentiment among taxpayers that a conservative understatement of income is a justifiable means of protective justice.

So long as the contact between the tax official and the taxpayer is but one link in an endless administrative chain, a preliminary skirmish to a bigger battle, then just so long will the taxpayer conserve his strength in evidential ammunition for some future more decisive struggle. This practice is doubtlessly good trial procedure but it does not bring about the improved tax administration for which we have been searching in vain for over a quarter of a century.

There is only one way to assure the taxpayer that he need

not be concerned with conserving evidential ammunition for future legal battles, and that is by removing the aura of impending combat within the litigious process and by placing interpretations within a professional atmosphere of an expert government agency exercising final authority over accounting questions. According to able law deans to litigate is to fight; one may add that to prepare to litigate is to prepare to fight. The combative spirit will be removed from tax administration when accounting interpretations are prevented from going into the judiciary process.

What is the justification for the supremacy of legalisms over professional business judgment and the resultant delay, cost, and confusion in our tax administration? What prevents accounting professionalism from solving tax problems in government? What is the source of resistance met by accountants in tax practice? Is there some necessity of governance which must perpetuate our failure? The answer lies in an analysis of aspects of our government which appear to date to have effectively prevented us from having a better tax administration. Any other approach to the analysis of the fundamental problems involved could lead only to arguments against persons and professions and against invested interests.

No one has ever maintained that tax accounting interpretations based on legalisms are more expert or just than those of professional interpreters. Yet the inept interpretations of the judiciary process are openly justified on the authority of that interpretative mechanism. It is implied that the courts and judges are possessed of a supernatural knowledge of any subject vested with a governmental interest. The argument continues on the basis of our doctrine of separation of powers, which permits the courts to maintain that their interpretations are those intended by Congress and that if such interpretations do in fact shock business and economic common sense, then the redress lies alone with Congress and not with correcting the judiciary interpretations of business data.

History shows conclusively that we have consistently tried to emulate the English tax procedure for its admitted excellence and that our failure to do so can be accounted for in our peculiar American style of judiciary. According to eminent authority our judiciary system was copied from the English in the eighteenth century with all its confusion and delay at that time. Many efforts have been made to reorient our system of justice more in accord with the present English system as reconstituted after nineteenth century legal reforms instituted by English laymen. Our present tax administration confusion is as much a part of our medieval system of justice as the present excellent English tax administration is but an intergral part of their present overall new model of judicial administration. The correlation is positive.

It is indeed beyond the scope, desire, or purpose of the thesis to discredit our form of government. However, it is an essential objective to connect our widely admitted failure to achieve a tax administration comparable to other achievments of an industrious ingenious people, to relevant governmental considerations. An improvement in tax administration should scarely be prevented with an argument that it would discredit our form of government. Especially is this so in view of the fact that we are becoming a nation of tax liars which is a discredit itself.

It is a lamentable fact that our history has shown the wisdom of maintaining restrictive control over government officials under our government of laws. The necessity for such a mode of control is lamentable in that it tends to be applied indiscriminately, that is, to those who need to participate in the governing process as professional men and not as politicians. Is not a distinction possible between politicians and professional men in government?

The study seeks to analyze but two governmental doctrines, namely, separation of powers and judiciary review, with a view of understanding their basic substance. It is emphatically those doctrines which if applied in a doctrinaire sense appear to justify the denial of discretionay authority in

tax administration. Whether or not it is appreciated by public accountants, the fact remains that their criticisms of court decisions and of statutes which would restrict the proper recognition of their professional services in tax administration are but criticisms of a doctrinaire application of those two doctrines of government.

It is not a mere question of the American versus the English form of government. There are two clear-cut, well-defined questions: First, do we have a tax administration which is fair and just and which enjoys the confidence of the people? Few, indeed, would hesitate to give a negative answer. Second, how can a tax administration worthy of the foremost nation in the world be achieved? Once those questions have been clearly analyzed, then in the interest of society that person or profession best trained to serve society in this particular situation must be selected for the service on merit alone rather than on adventitious position.

It is apparent that our tax officials believed that they could obtain the desirable English administrative results with the common law approach. They have been unsuccessful, but it is not clear that they today appreciate their inconsistent position. It is equally apparent that efforts to emulate the English tax administration while ignoring the fundamental basis thereof were foredoomed.

Taking Tax Administration out of the Courts

At various time during the 1909-1919 period it was necessary to call to Washington professional business interpreters to give meaning to an otherwise hopeless piece of legal draftsmanship, the income tax statutes. Gradually the interpretations were codified and arrogated to courts and bureau lawyers. As years of confusion passed with tax accounting interpretations becoming ever more involved in legalisms, cries arose for a more non-litigious, expeditious approach.

It should have been obvious that two biased advocates can implement the interpretative mechanism of the court only

by taking extreme biased views leaving the court the task of deciding finally between the extreme views. High officials of the Treasury were prone to criticize lawyers for the litigious nature of tax accounting interpretations, but the fault lies not with lawyers but rather with a particular type of interpretative mechanism which lawyers alone can properly implement.

The idea of the Board of Tax Appeals was copied from the English and grew out of the failure of the Commissioner of Internal Revenue to exercise independence and impartiality of viewpoint and in the realization that no income tax could be administered successfully in the atmosphere of a court proceeding. The Board was positively proposed as an informal, non-lawyer body. Yet in spite of the imminent collapse of tax administration those in control of the Board in the 1920 decade proceeded in the face of inexorable logic to the contrary to take it into the courts by persisting in their search for a "consistent body of uniform precedent." And this persistence occurred in spite of the fact that the legal elements of the country were at that time organizing the American Law Institute in an effort to slough off the uncertainty and unrelated mass of precedent resulting from the judiciary process. Apparently the concept of uniformity and certainty as personified by formulated accounting objectives, a qualitative concept, could not be understood as superior to the common law quantitative concept of uniformity and certainty. Mr. Justice Jackson admitted in his 1943 opinion of the *Dobson* case that thirty years of litigation has not produced such a consistent body of precedent, yet basically we still are relying on its eventual appearance.

After a special Congressional investigation in 1927 every effort was devoted to "taking tax administration out of the courts." Yet today, as evidenced by a 1948 investigation by the *same* Congressional committee, our aim is still "to take tax administration out of the courts." By comparison with 1927, the 1948 report said, tax administration was even more legalistic; too much atention was still given to protecting the

revenue rather than the taxpayer. Is this search for the *sine qua non* of tax administration never to end? Why have we not taken tax administration out of the court?

The Bureau has long sought for *judicially tempered* employees who in turn were to search for *the right answer,* thus avoiding formal litigation. One may conclude that a "legal" answer is not the "right" answer. We were supposedly taking tax administration out of the courts and some way must be found to supplant the independence theretofore supplied by formal court procedure. Yet, as history has demonstrated, the integrity or independence function cannot be removed from the courts and reposed in an individual *without also removing the interpretations from the courts and reposing them also in those properly trained persons.*

The extra-Bureau body, the Board of Tax Appeals, did become independent of the Bureau and the Commissioner, but in so doing it became a court and thereby inaccessible to the average taxpayer on such practical grounds as delay and excessive cost. The transition from the informal procedure of the Bureau to the formal procedure of the Board in the center of an innately unitary process is almost an insurmountable hurdle to the development of an integrated, unitary assessing process. The Commissioner avowedly attempts to arrive at the same result as a court would, but to do it without litigation, and he proposes to be doing this in an informal manner. But he is a litigant. His procedure may appear informal but his interpretations must of necessity be formal or like those of a court. The taxpayer cannot contest the Commissioner's position *without* going into the formal procedure of the court.

It was apparent from the beginning that the Board of Tax Appeals could not hope to handle the volume of cases coming to it from the Bureau. Formal procedure could not do the task. The American Bar Association agreed with the obvious fact that 100 members could hear more cases than fifteen members but centralized review of so many cases would be impossible. Once it became certain in 1927 that tax admin-

istration must be accomplished within the Bureau and not in the Board of Tax Appeals, renewed efforts were started within the Bureau. The proponents of the Board recommended the reconstituting of an intra-Bureau body of the type which had failed before and which the Board had been created to correct.

The new agency was called the Advisory Tax Committee and with its organization the efforts of the Commissioner to divest himself of his potential bias began again much as they had in 1919-1924 with the unsuccessful Committee on Appeals and Review whose own failure had been compounded by the eventual legalistic outcome of the Board. Actually the Advisory Tax Committee did not put the problem of tax administration back into the Bureau; rather the Bureau was brought ever closer to the Board with the creation of the Technical Staff and as soon as the Advisory Tax Committee failed, as was indeed foreshadowed in history.

Some may believe that the organization of the Technical Staff has taken tax administration out of the courts. Actually this has not happened. One can agree that we have effected pre-trial negotiation and thereby improved the judiciary process without implying that tax interpretations are not those of the court nevertheless.

The Technical Staff organization is ostensibly an instrument alone of the Commissioner's quasi-judicial capacity and not of his "prosecuting" capacity, but it is composed not alone of the Commissioner's representatives but also of representatives of the Chief Counsel's office, the former being referred to as conferees or technical advisers, the latter being attorneys. The attorneys are not officers of the Commissioner but rather of the court. The conferees may be assumed to do only accounting work but they are actually accounting technicians with a lawyer's interpretative philosophy. In any event it is the task of the attorneys to tell the conferees, that is, the accountants or appliers of the law, what the law is. Or stated differently, the attorneys interpret the accounting "law" for the "accountants."

The Commissioner cannot delegate finality to the Technical Staff which he does not himself have, except in so far as the courts tend to give weight to the Commissioner's one-sided interpretations. Even if the Commissioner could agree finally, the taxpayer does not have to. He can and will go to the court if he thinks that he can possibly win. Such a condition leads to plain "horsetrading" in the Technical Staff negotiations with the taxpayer. Thus is tax administration "taken out of the courts."

It is not the *finality to agree* on the part of the Commissioner to which the taxpayer objects; rather it is the Commissioner's practical, potentially biased *finality to determine*, outside of appeal to the courts, of which the taxpayer has cause to be wary. The distinction is basic. Note that in England the tax inspector, the counterpart of our Commissioner, exercises only finality to agree, while the finality of determination is reposed in the informal General and Special Commissioners and not in the formalism of a court. Our Commissioner is conceptually only a conduit through which all interpretations must rest eventually with the courts. Our Technical Staff assumes this function of the Commissioner and labors to negotiate with the taxpayer on the basis of legalisms in an effort to reduce formal litigation.

The conferees, as representatives of the Commissioner, handle all nondocketed cases and are very influencial in docketed cases short of actual court proceedings and the attorneys cannot settle such docketed cases without concurrence from the conferees. The American Bar Association wants this changed with a net effect of further formalizing tax administration. It wants the attorneys to have more authority in the non-docketed cases while reducing the authority of the conferees in the docketed cases. The divergencies appear on more basic grounds, however. The accountant- conferees only apply the tax accounting law, while the attorneys interpret the law for the accountants. But, says the Bar, one cannot really distinguish the application function from the interpretation function and so each conferee, the accountant-

applier, must have at his elbow some one to tell what the meaning of the law is which he is applying. This same tendency can be seen in the growing volume of the joint-practice of law and accounting. But the interpreter-applier balance cannot be maintained.

It is obvious that as the attorney-interpreter, as a functionary of the court, takes over the function of the applier that tax administration is going deeper into the court and the legalistic shadow comes ever closer to the taxpayer. The movement will not stop until even the Bureau is as legalistic as the Technical Staff is destined to become. If the interpretations are to remain in the courts, then lawyers must interpret them.

Relevant Factors of Law and Government

The thesis is not a dissertation on English and American constitutional law nor on the nature of law itself. However, the nerve of the resistance encountered by public accountants in tax administration runs all the way back to the subcellars of common law history and is innervated by an ancient English philosophy copied by our founding fathers but subsequently abandoned by England, the mother country. To understand the accountant's dilemna one must survey our governmental and legal history.

It is evident in this country that our legal philosophers still consider the inviolable, sacred concepts of free man, secured originally with the common law, as inseparable from the vague yet effective manner in which the English Justice Coke asserted the supremacy of law over the tyrannical King James in the seventeenth century. There apparently is but slight realization that not only is the ancient philosophical basis of the supremacy of common law unsuited to some aspects of an enlightened age but also that much of it is anachronistic when offered as the foundation for the newer governance concept of administrative law much of which is required by our complex economic and industrial society.

The tendency in America to associate the supremacy of law and the inalienable, inviolable spirit of justice with one professional group is a factor that presents the greatest obstruction to an improvement in income tax administration. So long as the expression "regime of law," as contrasted with that of an arbitrary dictatorship, is used to imply that our freedom is incarnate in methods of the legal profession as the members are presently trained, then just so long will the efforts to improve an admittedly inefficient, costly, and vexatious tax administration be siphoned back into the legalisms of common law judicial procedures which themselves have created the problem. This explains why tax administration has not, indeed cannot, be taken out of the courts.

In its original meaning the expression "government of men" (as contrasted with "government of law") was a negative expression implying a warning against a government of "arbitrary men" and against biased discretionary authority. It has, however, been used to beset the efforts of professional men in exercising informed judgment and discretion in connection with their discipline, after government decided to concern itself with a particular area of socio-commercial relationships traditionally associated with and practiced by a profession outside the governing process in direct service and support to society. Society has traditionally relied in part on a "government of men" in being served by doctors of medicine, by engineers, and by public accountants. And government has exercised supervision over these public professions in the interest of society. The proper approach for us to protect ourselves from a government of unqualified, arbitrary men is to increase the professional requirements of those permitted to practice in the public interest and not by turning their discipline into the non-congenial atmosphere of the judiciary process.

Why is it that an accountant who has been practicing his profession in non-tax matters in the public's interest finds himself accused of the unauthorized practice of law when he attempts to serve clients as part of the governing process in

tax administration? For some reason the "unauthorized practice of law" seems to strike at the very basis of our freedom and pursuit of happiness.

The public accountant, by implication, thus stands accused of tampering with our regime of law, our government of law, justice under the law, the separation of powers, etc., if he engages in tax practice. Again, how can he object without aligning himself with forces bent on overthrowing our government? The situation is preposterous and devoid of any substance.

One needs only to compare the English and American concepts of tax administration and the professional role of accountants in each system to appreciate that in England the accountant and the administrative concept of tax administration predominate. The lawyer has the same legal right as the accountant in England to participate in tax administration but he rarely does so. Tax interpretations would surely return to accountants in America were they not prevented from doing so by granting the legal profession a statutory monopoly.

As compared with the English unitary government of men exercising wide discretion, ours is a government of laws without such a discretionary attribute, purported to be a cognate of the doctrine of separation of powers and judiciary review. The distinction is of the greatest significance when one attempts to discover the reason for the apparent readiness of the English to accept the administrative concept along with a *net* income concept provision in their tax law and our equally apparent inability to do so and for our detailed revenue and deduction provisions determinable in the last analysis on the basis of legalisms, lawyers, and litigation.

A government of men places large discretionary authority in the hands of its highly qualified professional officials to agree on expert interpretations as to what constitutes a correct contrasting of revenue and related costs. At the same time such professional officials welcome the accounting pro-

fession as an adjunct to the judicial process and deal with them on a professional basis. On the other hand, only lawyers can participate in the common law judicial process as professional men; all others by comparison are mere technicians or expert witnesses. A government of laws rather than of men purposes to withhold the very discretion from accounting interpretations which in the last analysis is the foundation of accounting professionalism.

The mutual taxpayer-government relationship is tied up inextricably with the exercise of discretionary authority and judgment within an independent taxing process as in England which in turn consists of : (1) An informal independent professional tribunal exercising finality over fact questions; (2) a tax official, that is, the tax inspector with final authority to agree on, but not to determine, the tax liability; (3) a concept of net income expressed in the statute; and (4) an independent source of accounting facts.

In producing the client's accounts as the basis for the assessment the British accountant's obligation runs to both parties, namely, the inspector and the client. The accountant *is* the source of all facts. His duty is to produce all the facts from the accounts unadjusted for tax purposes. There are no ambiguous legal provisions as to what should be reported. The accountant's duty is clear and his very reputation depends on his discharging it honestly.

It is true, however, that the accountant is hired by one of two contesting parties to secure the minimum legal tax liability under the English system. But he cannot advocate by presenting only one side, because all the facts are already disclosed. He cannot advocate by resorting to a labyrinth of evidential and procedural legalisms, because such proceedings are conducted informally. The accountant does advocate but only in so far as advocating a correct business interpretation as personified by the net income concept is concerned.

It may appear as something of a paradox to discuss the effect of the separation-of-powers on accounting concepts in

tax administration when there is ample evidence that there is in effect no actual separation of powers. The answer to such an apparent inconsistency is fundamental. The powers are not separated; they are in effect centralized but the centralization is within a court interpretative mechanism. Tax administration will not under such conditions ever be taken out of the courts as so often expressly desired. Yet in order to prevent the centralization of such powers within an administrative (professional business) interpretative mechanism, the argument of the alleged need to keep governmental powers separated is blandly resorted to as witnessed by the legislative history of the Bar's Administrative Procedure Act of 1946. What had been a professional unitary public accounting service outside the governing process becomes a mechanistic, divided process in government under our doctrine of tripartite governmental powers. It is of extreme importance to note that along with a unitary government in England, which is made possible by the absence of the separation of powers theory and by the absence of judicial supremacy, the public accounting profession there does participate as a coordinated and integrated unitary process in tax administration. Ours is a government of law; theirs is one of men exercising discretion and bearing responsibitity.

Accountants must understand the fundamental basis for Justice Marshall's decision in Marbury versus Madison for therein lies the replanted seed from which has sprung this dilemma; therein lies the only justification for judiciary review and the supremacy of the legal profession as it operates to "convict" accountants of the "unauthorized practice of accounting law." Tax accounting as law has, under a peculiar theory of law, become sovereign and supreme over all except the courts.

It is clear from history that judicial review by federal courts was not a cornerstone of our freedom as conceived by our founding fathers. There was no precedent either in English history or in our own colonial history. Judicial review of legislative enactments is patently judge-made and resulted

from perhaps a compounding of historical accident and the political philosophy of Chief Justice Marshall expressed in Marbury versus Madison. It became a deliberate effort to give expression to Coke's doctrine of a supreme law which is beyond the power of the people through Congress to alter. It arrogates to the courts the autocratic authority long since denied to English kings, albeit a benevolent authority in the interest of preserving personal liberty. Its effect is to deny to public accountants a truly professional sphere in tax administration. It is rather ludicrous in this enlightened age to believe that accounting concepts which have slowly emanated over the centuries from the mass of complicated business and economic relationships should be assumed a part of the judge's supernatural knowledge of fundamental law.

It is apparent that judicial review is justified as the only means for keeping separate the three powers of government which have a strong inherent tendency to merge and unify outside the judiciary process. The tendency to merge is especially strong, in fact it is inevitable, when the unitary process of accounting interpretations is, for tax purposes, strewn among the legislature, the executive, and the courts, with overall responsibility for results widely dispersed.

In his book published in 1942, Professor Pound found a justification for judiciary review which did not rest on a doctrinaire concept of the separation of powers. He asserted, without specifically mentioning tax administration, that courts should control agencies through judiciary review, because by training judges are more judicial and better trained for seeing that justice is done. Furthermore, said he, judiciary procedure is better designed to insure the integrity of decision making. The administrative process, he continued, is personal and hence often arbitrary, while "judicial" justice is impersonal but never arbitrary; the former is guided by ends or objectives, the latter by means. The administrative process is capable of being more efficient than the judicial process can ever be, he admitted, but the judicial process is a safeguard against corrupt magistrates. Judges, he added,

are forced to seek authoritative grounds and are subjected to the ever sensitive criticisms of the legal profession and the inevitable appeal to higher courts.

One can readily agree with Mr. Pound's objectives without conceding that his judiciary procedure is the only one that can accomplish them. It is not likely that public accountants would acknowledge any alleged superiority of the legal profession over the accounting profession in matters of judicial temperament, sensitivity to fellow-professional criticism, or impartiality.

Few would doubt the validity of Mr. Pound's convictions in so far is he is comparing judges with congressmen in view of the political responsibilities of the latter. However, public accountants could take sharp issue with Mr. Pound over the alleged superior judicial equipment of lawyers who come to the bench after years of training in the most biased professional approach in history. On the other hand, the very professional foundation of the public accountant is his lack of bias and independent viewpoint. This judicial element of the public accountant, aside from his technical knowledge, can also be inculcated in a professional body of tax experts. Surely this is possible, if one can believe that lawyers can become the paragon of judicial temperament on being elevated to a judging position in controversies, having theretofore considered only one side.

Mr. James Landis related the justification for control over interpretations, that is for judicial review, directly to informed knowledge and training, He, like Professor Pound, did not concur in any vestige of supernatural knowledge of law as a justifiable basis for review. He asserted that no fixed line of distinction could be drawn between questions on the basis that one is a law question and another a fact question. Courts are prone to use the vague law-fact question as a device to obscure real motives for reviewing or not reviewing, since only law questions come peculiarly within the province of judges. Such a device lends itself well to our poorly conceived and ill-expressed theory of the supremacy of

law. Said Mr. Landis, review authority should depend on expertness as regards the question to be reviewed. Supremacy of law in its relation to judicial review stems from the original idea that only judges were expert in solving disputes.

There is implicit in the argument against administrative finality that it would give uncontrolled discretionary power to a government official. There is also implicit in the argument against administrative finality that judges do not use discretion and thereby the law is made certain and safe from arbitrariness. Of course few but the naive would maintain that judges do not make law, that is, use discretion. Yet those who might hold to the contrary would argue that the slight fib is necessary in order to instill public faith in the law. It is the consensus among leading jurisprudentists that such dupery is not harmless. It leads, sooner or later, to a distrust of the judges and to a disrespect for their opinions. It is apparent when accountants object to being divested of professional control over their own discipline that they are objecting along with the rest of the public to being duped for their own good.

Judges decide as much on a basis of intuition and hunches, supplying the legal reasoning with proper principles and concepts subsequently, as they do on the basis of *stare decisis*. Precedent can be found to support any side of a case, as witnessed by numerous split decisions and frequent reversals of the original decisions by subsequent appellate split decisions. Yet accountants are told that their interpretative problems must be withheld from them within the taxing process because as a group they cannot agree on what the interpretations should be. The only real distinction between discretion in accounting matters as exercised by a lawyer-judge and that of an accountant-judge is that the former is exercising an uninformed judgment while the latter, by his training and experience, is exercising an informed judgment. It is the lack of business knowledge on the part of lawyer-judges that gives us our tax anomalies so roundly criticized by businessmen.

The resistance of common law judiciary interpretations to

the use of professional business interpretations is similar to the traditional resistance of law to equity. Our failure to permit professional business interpretations is our refusal to recognize equity in tax justice. And, according to Robert H. Jackson now a member of the Supreme Court, equity is essential in tax interpretations but to acquire it the interpretations must be divorced from the judiciary sieve. And he attempted to implement his philosophy in his *Dobson* opinion a decade later in 1943 by denying judiciary review of accounting tax questions. In short, he believed in administrative finality. The Bar overruled him, however, by forcing through Congress the Administrative Procedure Act of 1946 and by subsequent legislation.

The Bar Enforces its Will on the Governing Process

The American Bar Association sought to model its Administrative Procedure Act of 1946 after the Tax Court which is full evidence that it believes government in general, as is taxation in particular, should be administered in the litigious pattern. And all this was accomplished in spite of asserted efforts to remove tax administration from the courts. The Bar sought to achieve its purpose by making judiciary review mandatory in so far as possible and by requiring that formal "administrative" records be compiled at appellate stages before the agencies. The Act was directed against the Supreme Court's propensity to grant finality to the agencies, as witnessed by the *Dobson* case, as much as against any other single condition.

Thus, as with the evolution of the Board of Tax Appeals into a court, a formal record is made a requirement and then accountants and other laymen are faced with a *fait accompli*, that is, they are not qualified to partake in a proceeding which is compiling a formal record for possible judiciary review. There is little evidence that the accounting profession clearly perceives this characteristic two-step approach of the Bar as it goes about trying to re-impose its particular interpretative philosophy on all agencies of government.

It is idle folly to assume that the Bar is trying to deny accountants control over their own discipline, yet that is precisely the result. The Bar is attempting to correct a serious condition in the government process with an approach which itself caused the serious condition. Bureaucracy in taxation is the result of trying to administer government in a litigious pattern and not from any other reason. The problem concerns the providing of personnel in government and giving them authority to interpret problems in which they are well trained. This does not imply granting arbitrary authority to unqualified persons, nor to qualified persons inhibited by legalisms; it implies simply permitting truly qualified persons to serve society and to accept responsibility for the results as would professional people outside the governing process. The control over those persons can be exercised by increasing the professional standards which they must meet. There is no better professional product available and it should be provided in the governing process.

The Bar is attempting to implement and improve the only interpretative mechanism and philosophy that it is presently trained to understand, that is, those based on the litigious process and legalisms. This is doubly important once it is understood that the Bar controls Congress through a majority of lawyer-members and that it controls absolutely the important judiciary committees of both houses. It will inevitably seek to impose its own experience on government; indeed, it has already done so. The most hopeful sign for the future is the realization among leading legal philosophers that our legal education is poorly adapted to present governmental needs. As efforts go forward to re-educate those controlling the processes of government and to improve our judiciary system more in conformance with that of the English, it is inevitable that sooner or later the lawyer element of our society will become better "accounting clients" and less prone to rush in where the better informed would hesistate to tread. Our form of government in the last analysis will depend upon the philosophy of those implementing it and not upon references to

what our founding fathers supposedly predicted that we must do to maintain our freedom.

Our tax administrators have had ample opportunity to analyze our tax problems. Are they now prepared to solve them? Or will they perpetuate them on the theory that solving them would discredit the philosophy which has created our tax problems? The philosophy of the Administrative Procedure Act of 1946, which is predicated on an adversary government-taxpayer relationship, and its complementary proposed Administrative Practitioners' Bill, which would restrict non-lawyers in participating in the governing process, do not augur well for a truly administrative tax settlement procedure. One cannot say how successful the currently proposed informal tax settlement board will be, but he can state with some historical assurance the requirements for the success for any such board. Whether or not the board will succeed will depend upon whether or not those requirements are met.

The Requirements For Successful Tax Administration: A Conclusion

As a prerequisite to a successful tax administration the detailed revenue and cost provisions of the present law must be replaced with a net income concept recognizing the importance of seeing relevancy between revenue and cost. An effective recognition of accepted accounting principles, as so long and ardently urged by the American Institute of Accountants, will accomplish this objective of setting a net income concept. Effective recognition of accepted accounting principles and concepts must depend upon the courts relinquishing interpretative control of accounting questions. This is to say that administrative finality must be placed in an expert independent professional body of interpreters as in England.

The Commissioner of Internal Revenue should be given the authority to agree finally as to the tax liability, but in no case should he, as at present, have the authority to determine the

tax liability. The determinations should rest finally with the local expert tax bodies. Proceedings before these independent bodies must partake of a professional or academic discussion of what is net income, which is to say, a discussion of what are the related costs of the revenue being reported. Such a search for economic justice will be nearly void of legalisms but most certainly not devoid of uniformity and consistency of results. This does not mean that the exigencies of the endeavor will not need certain procedural requirements. What it does mean is that the application of informed judgment and experience toward the justice implicit in the matching of revenue and cost will produce fairer results, more expeditiously and with less cost and confusion than has heretofore afflicted our tax administration.

The concept of an independent board espoused here does not preclude lawyers from its membership. It merely precludes the ineptness of the common law judicial interpretation of business problems. The newly constituted legal philosophy as proposed by eminent legal scholars is entirely compatible with this concept of an independent board. Indeed such a concept has been tried by various state and local governments, not to mention the federal government experience with the contract settlement boards during World War II and in the Security and Exchange Commission. Those experiences were eminently successful.

There will not be interpretation by litigation before this new board. Practitioners will appear before it on the basis of their ability to *explain* business data to "judges" qualified to interpret or decide the issue on the basis of their own experience and knowledge rather than, as at present, on the basis of the ability of two advocates honor-bound to prejudice the mind of the judges toward their own individual client interest.

The individual public accountant does not want the final authority to determine the tax liability of a taxpayer. There are too many situations where the exercise of judgment as to equally correct alternatives could be swayed so as to reduce

the tax liability. Furthermore, should the certifying accountant have to exercise such authority he could easily lose his fiduciary position as between the independent board and the taxpayer.

Once accepted accounting principles and objectives are effectively recognized, as the basis of assessment, the interpretative techniques of accounting will form the basic philosophy of the independent board. Certified statements as now prepared by public accountants unadjusted for tax purposes will become the independent source of facts. At present one must interpret the tax law in the very process of furnishing information for tax purposes under our so-called self-assessing system, because of the divergencies between ordinary business interpretations and those required by legalisms.

Given the responsibility for furnishing *all the information according to the accounting records* without having to determine the tax base, the accountant is honor-bound to place *all facts* before the board. A lawyer is not so bound. The accountant may then appear before the board to explain those facts and to advocate *on the basis of all facts* as to the best professional business interpretation. The admissibility of a deduction will not depend on a legalism; it will depend upon its relevancy to the revenue reported.

The foregoing requirements for an administrative tax procedure are not new. We have sought them since the formative period of what is now the Tax Court. We now know why we have been unable to meet those requirements. The thesis attempts to disclose the reason for our inability and lack of success.

It is true that no governing process in a democracy can ignore the capabilities of the citizens. Are we as a nation capable of embracing the administrative concept of a tax settlement board? We were not capable of doing so in 1924, it seems. If we are not now capable then an improved tax administration must await a more basic accomplishment of our system of education. The public accountant rides the tide

of public confidence which in turn depends upon the understanding by the public of the issues involved. What might by some tests be an inferior system may indeed be the preferable one, if the citizenry trusts and understands it in preference to one deemed sounder from a purely academic point of view. The American accounting profession is relatively new as compared with our overall traditional distrust of public officials and government, however deplorable or necessary this might be. Without the constituting of an independent board trusted implicitly by the public, only limited gains can be made in improving our present tax administration.

It is not certain that tax officials conceive the public accountant to be the public servant that the officials of the Security and Exchange Commission do. But this is doubtlessly due to the fact that tax administration at present does not afford public accountants the opportunity to perform a public service in taxation similar to that they perform in imparting public confidence to management's representations to investors through financial statements.

In any event the administrative approach cannot under any circumstances be instituted overnight. It must be done gradually by offering the administrative approach as an irrevocable choice in lieu of the present procedure, until such time as the taxpayers have indicated that they no longer wish the present system continued.

It is fundamental that tax justice be made more accessible to more taxpayers than at present in order to increase their confidence in a democratic government, because such confidence, it is submitted, is a basic requirement for the survival of a democracy.

VITA

James Owen Eaton was born on February 13, 1914 in Sunfield, Illinois. After graduating from Du Quoin Township High School, Du Quoin, Illinois, in 1933, he entered the University of Illinois and received the degree of Bachelor of Science from that institution in June, 1937. He entered the employ of the International Harvester Company on graduation and remained with that company until May, 1941 when he went on active duty in the Army as a First Lieutenant. He served in the American and Mediterranean Theaters.

On being separated from the Army in 1946 as a Lieutenant Colonel he entered the Graduate College of the University of Illinois. He held a half-time graduate assistantship from April, 1946 until September, 1947 when he was appointed an instructor on three-fourths time. He taught full-time from September, 1948 but resigned his teaching position in September, 1949 to devote himself to his doctoral research.